ST 01-0100-GIL 06/18/2001 REPAIRS

This letter discusses the taxability of maintenance agreements and repairs. See 86 Ill. Adm. Code 140.301. (This is a GIL).

June 18, 2001

Dear Xxxxx:

This letter is in response to your letter dated January 26, 2001. We apologize for the delay in responding to your inquiry. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 subsections (b) and (c), which can be found at http://www.revenue.state.il.us/legalinformation/regs/part1200.

In your letter, you have stated and made inquiry as follows:

> We have registered to do business in the state of Illinois. I have some questions regarding the application of sales/use tax in the state. Let me give you some background as to what our company does. We provide service & maintenance to companies for their UPS (uninterruptable power source) systems, HV AC systems, generators, and DC Power stations (battery back-up systems). The service & maintenance agreements are generally in the form of a written contract, which extends for a minimum of one year. We will also perform emergency services on an as needed basis to troubleshoot/repair systems when down or not functioning properly. In addition we will also be installing new systems for new clients with product being shipped directly to the state of Illinois (direct to customer's site). We also anticipate some electrical construction to occur in the future as our operations in IL expand.
>
> In summary I need to know how to tax the following invoices:
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> 1. Maintenance agreements with customers with whom we do not have exclusive rights (they choose us as service providers), lump sum invoicing.
> 2. Emergency repair services, which are one time, time & material type invoices.
> 3. New installations where we purchase equipment, the equipment is shipped direct to the state of IL, (customer's site) and we install the equipment, usually lump sum invoices.
> 4. Electrical installations to include construction related activities such as wiring through walls and constructing raised floors, most of these invoices are lump sums.
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> If you could send a response as to how to tax each of the above numbered, it would greatly assist our company in determining the proper allocation and collection of sales tax.

Thank you in advance for your assistance in this matter.

DEPARTMENT'S RESPONSE:

MAINTENANCE AGREEMENTS

The taxability of maintenance agreements depends upon if charges for the agreements are included in the selling price of the tangible personal property. If the charges for the agreements are included in the selling price of the tangible personal property, those charges are part of the gross receipts of the retail transaction and are subject to tax. No tax is incurred on the maintenance services or parts when the repair or servicing is performed.

If maintenance agreements are sold separately from tangible personal property, sales of the agreements are not taxable transactions. However, when maintenance services or parts are provided under the maintenance agreements, the seller of the maintenance agreement will be acting as a service provider under provisions of the Service Occupation Tax Act (SOT). The SOT provides that when service providers enter into agreements to provide maintenance services for particular pieces of equipment for stated periods of time at predetermined fees, the service providers incur Use Tax based on their cost price of tangible personal property transferred to customers incident to the completion of the maintenance service. See the enclosed copy of 86 Ill. Adm. Code 140.301(b)(3). Further, the purchaser of the separate agreement or warranty is not charged tax on the labor or tangible personal property that is transferred incident to the completion of the maintenance agreement. If a deductible is charged to the purchaser under the terms of the separate agreement, the deductible is also not subject to tax.

In the situations you describe in your letter, this can be somewhat confusing depending upon whether you sell the warranty agreement and perform the service or a third party sells the warranty agreement and subcontracts out the service work to you. In the latter situation, you may be acting as a subserviceman in a multi-service transaction making sales of service to the warranty seller (primary serviceman). See the discussion of multi-service transactions, below.

REPAIRS

Illinois Retailers' Occupation and Use Taxes do not apply to sales of service that do not involve the transfer of tangible personal property to customers. However, if tangible personal property is transferred incident to sales of service, this will result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon which tax base the servicemen choose to calculate their tax liability. For your general information we are enclosing a copy of 86 Ill. Adm. Code 140.101 regarding sales of service and Service Occupation Tax.

Under the Service Occupation Tax Act, businesses providing services (i.e., servicemen) are taxed on tangible personal property transferred as an incident to sales of service. See the enclosed copy of 86 Ill. Adm. Code 140.101. The purchase of tangible personal property that is transferred to the service customer may result in either Service Occupation Tax liability or Use Tax liability for the servicemen depending upon which tax base the servicemen choose to calculate their tax liability. The servicemen may calculate their tax base in one of four ways: (1) separately stated selling price of tangible personal property transferred incident to service; (2) 50% of the servicemen's entire bill; (3) Service Occupation Tax on the servicemen's cost price if the servicemen are registered de minimis servicemen; or (4) Use Tax on the servicemen's cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of the sale of service. The tax is then calculated on the separately stated selling price of the tangible personal property transferred. If the servicemen do not separately state the selling price of the tangible personal property transferred, they must use 50% of the entire bill to the service customer as the tax base. Both of the above methods provide that in no event may the tax base be less than the servicemen's cost price of the tangible personal property transferred. See the enclosed copy of 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. See the enclosed copy of 86 Ill. Adm. Code 140.109. Servicemen may qualify as de minimis if they determine that the annual aggregate cost price of tangible personal property transferred as an incident of the sale of service is less than 35% of the total annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphics arts production). Servicemen no longer have the option of determining whether they are de minimis using a transaction by transaction basis. Registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon their cost price of tangible personal property transferred incident to the sale of service. Such servicemen should give suppliers resale certificates and remit Service Occupation Tax using the Service Occupation Tax rates for their locations.

The final method of determining tax liability may be used by de minimis servicemen that are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Such de minimis servicemen handle their tax liability by paying Use Tax to their suppliers. If their suppliers are not registered to collect and remit tax, the servicemen must register, self-assess and remit Use Tax to the Department. The servicemen are considered to be the end-users of the tangible personal property transferred incident to service. Consequently, they are not authorized to collect a "tax" from the service customers. See the enclosed copy of 86 Ill. Adm. Code 140.108.

The situation you describe for your warranty repairs may involve a multi-service situation. For general information regarding multi-service situations see the enclosed copy of 86 Ill. Adm. Code 140.145. Multi-service situations exist when a primary serviceman subcontracts work to a secondary serviceman. In multi-service situations, a primary serviceman's cost price is determined either by the separately stated selling price of the tangible personal property personal property transferred from a secondary serviceman, or if the secondary serviceman does not separately state the cost of goods, it is presumed that the primary serviceman's cost price is 50% of the secondary serviceman's total charge. See 86 Ill. Adm. Code 140.145.

Determining specific tax liabilities in multi-service warranty repair situations are very fact specific and will depend upon what tax base each of the servicemen have chosen and the location (in-State or out-of-State) where all or part of the service repair takes place. If you need a ruling regarding a specific transaction, we recommend that you write our office for a Private Letter Ruling providing all the information regarding that specific transaction.

INSTALLATIONS

Please be advised persons who take tangible personal property and permanently affix it to real estate in Illinois act as construction contractors and incur Use Tax liability on their cost price of tangible personal property they physically incorporate into realty. They owe Use Tax because they are considered the end users of the materials they take off the market to permanently affix to real estate. See G. S. Lyon & Sons Lumber & Mfg. Co. v. Department of Revenue, 23 Ill.2d 180 (1961).

Construction contractors act as retailers and incur Retailers' Occupation Tax liabilities when they sell items over-the-counter or they sell items that remain tangible personal property when installed. When contractors act both as contractors and retailers of building materials, they can give a certification to suppliers that they, the contractors, will self-assess and pay tax if they do not know at the time of purchase how they will use the tangible personal property. Please refer to subsections (b)(1) and (2) of the enclosed copy of 86 Ill. Adm. Code 130.2075.

Please note that Section 130.2075(b)(2) explains that "the purchaser may not give such certification to his supplier unless the purchaser, if he will convert the tangible personal property into real estate in this State, agrees to, and does, assume the liability for reporting and paying the tax to the Department in the same form (Illinois Retailers' Occupation Tax, and local Retailers' Occupation Tax if applicable) in which the supplier would have reported and paid such tax if the supplier had accounted for the tax to the Department." Therefore if the purchaser converts the tangible personal property into real estate, he must include its cost price on his sales tax return as taxable receipts and pay applicable local Retailers' Occupation Tax in addition to the State Retailers' Occupation Tax.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b) described above.

Very truly yours,

Terry D. Charlton
Associate Counsel

TDC:msk
Enc.